

ROYAL COMMISSION *re* HOME BANK

INTERIM REPORT

JUNE 10, 1924



OTTAWA
F. A. ACLAND
PRINTER TO THE KING'S MOST EXCELLENT MAJESTY
1924

INTERIM REPORT

To His Excellency General the Right Honourable Lord Byng of Vimy, G.C.B., G.C.M.G., M.V.O., Governor General and Commander-in-Chief of the Dominion of Canada.

In compliance with the Commission of Your Excellency dated the 27th day of February, 1924, by which I was appointed a Commissioner to make investigation into all material and relevant facts in relation to the Orders in Council attached to the above-mentioned Commission, I have the honour to submit the following interim report.

This report does not contemplate a consideration of all the matters referred to, but has to do with such of them as have a bearing upon the facts alleged in a petition presented to Your Excellency by an executive committee of the depositors of the Home Bank of Canada, dated the 23rd day of February, 1924, praying that those who suffered loss as such depositors because of the facts set out in the said petition, should be indemnified against such loss on grounds set forth.

The hearing in the matter was commenced before me in the city of Ottawa on the 16th day of April last, and evidence was taken under oath both at Ottawa and at Toronto on divers days between that date and the 20th day of May, 1924, inclusive; Mr. E. Lafleur, K.C., and Mr. H. J. Symington, K.C., appearing throughout as counsel for the Government of the Dominion of Canada; Mr. H. J. McLaughlin, K.C., Mr. A. G. Browning, K.C., and Mr. W. T. J. Lee appearing for the depositors during the continuance of the hearing; and in addition to the above-named counsel, Sir Thomas White, K.C., Mr. McGregor Young, K.C., and Mr. R. A. Reid appeared for different interests from time to time.

In view of the questions raised and argued before me during the investigation, it is well, I think, to clearly define the proper range of the present inquiry, as limited by the Orders in Council under which I am directed to act. No ambiguity attaches to them, and it is my duty to confine myself circumspectly to the letter of the instructions received.

I am the more desirous of doing so, inasmuch as the courts of the province, on their civil and criminal sides, are concerned with the conduct of many of those whose names have been mentioned in the testimony adduced before me, and actions both civil and criminal have been commenced against some of them. Regard for the obvious proprieties of the situation, demands complete reticence on my part concerning the issues which have been thus judicially raised and as to which the proper tribunals are now making inquiry. While some reference to their acts as such directors was unavoidable during the taking of the evidence, such reference was made for the most part wholly ancillary to the depositors' claim, and in explanation of the grounds upon which this claim is based.

I am further particularly concerned to confine myself strictly to what I am now directed to do, since it is said that the Parliament of Canada may be asked to take certain action in respect of the petition filed by the depositors, and I appreciate how jealously the frontiers of parliamentary responsibility and action are guarded. I do not consider that the commission requires me to set foot over that line. I am asked to answer these questions, and whether the findings of fact involved in such answers be accepted or not, or whether any

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action may be taken upon them, is not for me to say. While I realize that I have permission to express an opinion on the result of the investigation and the evidence taken, I recognize that the responsibility for any action thereon really lies elsewhere, and those who carry that burden should, I think, approach their task unaffected by the expression of any opinion on my part. My duty, as I see it, is simply to put them in possession of definite answers to the questions submitted, as best I may. I have been urged by certain of the counsel to say that in my opinion compassionate allowance should be made to the depositors who have suffered loss, and also to pronounce what would amount to a finding of negligence on the part of some responsible for the administration of the Department of Finance in its oversight of the bank. While my right to discuss the discretionary acts of a minister of the Crown, where no dishonesty is alleged, has been sharply challenged by other counsel, on the ground that the jurisdiction therein abides with Parliament itself, nevertheless I have been further invited to express an opinion upon the diligence and honesty of administrative acts. But in strictly confining myself to answering the questions set out in the Orders in Council, I am constrained to lay aside any inquiry into matters suggested immediately above and to refrain from comments upon facts, concerning which various counsel have asked that pronouncement may be made, especially regarding the conduct of ministers of the Crown responsible for the administration of the department immediately involved.

While it would, I think, be impossible for one to follow the evidence and discussion without forming an opinion, and perhaps a strong opinion, upon the questions so raised, yet the expression of such opinion, to my mind, would serve no useful purpose, but rather cloud the direct issues to which I am commanded to give attention. It may be that other matters related to the Home Bank will be explored later, as coming within Order in Council number 412, directing the commissioner to investigate:—

“ the affairs of the said bank during the whole interval between the issue of the bank's charter and the failure of the said bank ” etc., but in this interim report I am confining myself solely to the task of finding answers to the questions set out in the Order in Council number 306, which questions are as follows:—

“ 1. Whether, in the years 1915, 1916 and 1918, representations were made to the Department of Finance of the Dominion of Canada respecting the condition of the Home Bank of Canada, and, if so, what representations were so made.

“ 2. Whether, if such representations were made, a state of affairs was revealed concerning the condition of the said bank such as would have justified an investigation under the powers conferred upon the Minister of Finance by section 56A of the Bank Act.

“ 3. What action if any was taken by the then Minister of Finance upon such representations as may have been made.

“ 4. What effect would an audit under section 56A of the Bank Act if made in 1915, 1916 and 1918 have had upon the conduct of the affairs of the said bank and upon the position of the present depositors.

“ 5. What was the financial condition of the said Home Bank of Canada in the years 1915, 1916 and 1918, respectively, and what steps, if any, could have been taken by the Government to save the situation.”

Adhering to the course indicated above and in compliance with what I consider to be the directions of the commission in this regard, I desire to state specifically my answers to the questions above set out.

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Question 1 is as follows:—

“ 1. Whether, in the years 1915, 1916 and 1918, representations were made to the Department of Finance of the Dominion of Canada respecting the condition of the Home Bank of Canada, and, if so, what representations were so made.”

It will be observed that this question contains two component inquiries:—

First, whether during the years mentioned any representations were made, and,

Second, if such representations were made, of what nature were they?

I think it was established by the evidence that in the year 1915 no representations were made to the Department of Finance respecting the condition of the bank.

With equal clearness it is apparent that during the year 1916 such representations were actually made to the Department of Finance. They are evidenced by exhibits submitted and filed numbered from “ 2 ” to “ 42 ” inclusive. These exhibits show that such representations originated from Messrs. T. A. Crerar, John Kennedy and John Persse, who then were directors of the Home Bank, residing in Winnipeg. In these communications, as well as in many others, Messrs. Crerar, Kennedy and Persse are termed “ the western directors,” and it is clear that originally they assumed such position with a view especially of scrutinizing the operations of the bank in Manitoba and the western provinces of Canada. Such representations took the form of three separate communications to the then Minister of Finance, each bearing date the 22nd day of January, 1916, the first of which in order of filing is headed: —

(Ex. 2. p. 12).

“ *Re Home Bank of Canada.*
Re Prudential Trust Loan.

Confidential memorandum to the Minister of Finance.”

It is signed thus:—

“ James Fisher,
For Western Directors.”

The second communication is headed:—

(Ex. 3. p. 15).

“ *Re Home Bank.*

Confidential memorandum *re* Barnard loan.”

and is also signed:—

“ James Fisher,
For the Western Directors.”

The third communication is headed:—

(Ex. 5. p. 17).

“ *Re Home Bank of Canada.*

Confidential memorandum to the Honourable, the Minister of Finance,
from Messrs. Crerar, Kennedy and Persse, Directors of the Home
Bank residing in Winnipeg.”

and is signed:—

“ James Fisher,

On behalf of and by instructions of the three Western Managers.”

There are contained in the communications themselves, as well as in the accompanying statements attached, particulars concerning various loans and complaints about the way the bank's business was being transacted and other matters which will be detailed as far as necessary in answer to the second part

of this question. There were also submitted to the Minister of Finance at that time, accompanying such communications, many letters written by and on behalf of the western directors, and replies thereto, covering the period extending from the 17th day of February, 1915, to the 18th day of January, 1916.

From all this correspondence it is apparent that in the year 1915 the affairs of the bank were under criticism on the part of the western directors, and that they were making complaints to the eastern directors concerning certain loans and the general lack of oversight and proper care that existed, and this is especially evidenced by the communication of February 17, 1915, by Messrs. Crerar, Kennedy and Persse to A. C. Macdonell, M.P. (ex. 10, p. 24).

The letters which passed between the western and eastern directors, of the year 1915, are attached to the file brought to the attention of the department in the year 1916, and admittedly came under the attention of the Minister of Finance at that time.

It is therefore abundantly clear that as far as the year 1916 is concerned, it must be reported that representations were made to the Department of Finance of the Dominion of Canada respecting the condition of the Home Bank of Canada.

The same answer must be made as regards the year 1918, for all the communications and documents above referred to were again brought to the attention of the Minister of Finance in the year last mentioned and he received further representations concerning the condition of the bank by way of a communication from Mr. W. A. Machaffie, for many years an official of the Home Bank. The contents of these communications will be referred to in answer to the second part of this question.

In addition to the above, there were also interviews during the years mentioned between the then Minister of Finance and the president and other directors of the bank as well as with Mr. Z. A. Lash, counsel for the Home Bank.

Summing up what is above written as regards the first part of question number 1, I repeat that no representations were made to the Department of Finance of the Dominion of Canada respecting the condition of the Home Bank during the year 1915; but that such representations were made to the Department of Finance during the year 1916, and during the year 1918.

Turning now to the second part of this question, which asks what representations were made:—It is to be noted that they take the form of three special memoranda, each bearing date the 22nd of January, 1916, and signed by James Fisher for or on behalf of the western directors (ex. 2, p. 12; 3, p. 15; and 5, p. 17). Of these, one is more general in its character and will be referred to first in order (ex. 5). It drew to the attention of the Minister the fact that out of a paid-up capital of not quite two millions of dollars, about \$500,000 was held in the West; that a few years then previous, three western stockholders were placed on the board of directors to deal with the western business; that they met weekly and reported regularly their action to the head office. No eastern director met with them, and none of the three attended the head office meeting in Toronto unless specially requested. Also that in the fall of 1914 the western members became apprehensive that the business of the Toronto branch was not in good condition whereupon they went to Toronto about the middle of November of that year, for the purpose of acquainting themselves with the condition of affairs of the home branch, as well as to make complaint of the lack of money for loans in their part of the country; that upon their request meetings of the directorate of the bank were at once called, lasting for four days, during which they for the first time learned that there was no regular inspection of the Toronto office, the reason alleged being that the business there transacted was under weekly supervision by the eastern members of the board. The complainants set out that they were not satisfied with the information furnished at these

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meetings, especially as to certain accounts, one of which on the first day of meeting was reported at the figure \$1,100,000, but on the second day an error was admitted to have been made, and the amount was raised to \$1,500,000, and on the third day it was placed at \$1,780,000; and concerning which loan it appears that even the largest figure given was too small, for at the meeting on the 30th of the following month, it was disclosed that the amount involved was nearly two millions of dollars. They also learned that the general manager was indebted to the bank in a sum first reported as \$35,000, and which was afterwards disclosed to be \$76,000, and the like situation existed regarding other customers (ex. 10, p. 24). It was further represented to the minister that although they had urged an immediate inspection of the Toronto office, and that the report be ready for the next annual general meeting, it was not ready at that time, and the annual report of the bank had been sent to Ottawa without the western directors knowing of its contents. Also that they refused to acknowledge the validity of the election of Messrs. Barnard and Haney to the board of directors, in the place of Messrs. Gooderham and McNaught, who had resigned, and the western directors notified the manager that they held themselves free to contest the validity of these elections (ex. 9, p. 23). Another matter of complaint was that at the December meeting a resolution had been submitted and approved to the effect that a committee be appointed consisting of the assistant general manager and two others to carry on the affairs of the bank, and to specially pass upon all credits and make every possible effort to collect all overdue loans, and submit the earliest possible statement showing the present condition of the bank, with recommendations, which resolution was not pressed to its passage as the general manager was at that time out of the country in ill-health, but it had been agreed that this course would be taken, but the agreement was ignored and nothing done pursuant to these plain directions (ex. 10, p. 25). This communication was of a general nature, and in that sense supplementary to the particulars set out in the other two accompanying memoranda referred to below, but all the matters above noted were contained therein, and in accompanying exhibits, and thereby brought to the attention of the Minister of Finance.

The memorandum filed as exhibit number 2 is of the same date and has reference to the loan made by the bank to the Prudential Trust Company. The facts laid before the minister in this document showed that the bank had parted with \$500,000 in a transaction involving the Prudential Trust Company and the New Orleans Southern and Grand Isle Railway Company, which was explained by the general manager in a communication to Mr. Crerar, under date of December 24, 1915 (ex. 31, p. 53), part of which reads:—

“James Mason to T. A. Crerar

“Messrs. Warren, Bristol and Morden were the promoters of the reorganized New Orleans Southern and Grand Isle Railway Company, and as such made application to the Prudential Trust Company, Limited, for a loan of \$500,000, which the trust company agreed to make, provided the bank would advance to the trust company the necessary funds. It was afterwards discovered by the solicitor for the trust company that under its charter it could not make the advance, but could accept the funds from the bank for investment by way of loan to the railway company and that the trust company could guarantee repayment to the bank—there was no connection between Warren, Bristol and Morden and the bank—their dealings being direct with the trust company.”

There is a feature of this loan upon which I desire to make no comment, but feel it necessary to state, and that is, that apparently, preliminary to the

loan being made by the bank, a like sum of \$500,000, being trust funds of one of the provinces, then in the hands of the Prudential Trust Company, was deposited in the Home Bank. It was considered by certain of the directors that in some way these funds would be security for the loan to the trust company, but obviously such could not be the case, and on reference to the bank's solicitor, advice to that effect was obtained. The security taken for this loan was a note signed by the Prudential Trust Company in favour of the Home Bank of Canada, and \$750,000 of bonds of the railway company as collateral security. Now this loan represented a very large proportion of the bank's capital, and the western directors whose amounts for western accommodation were being curtailed, were unsparing in their criticism of the transaction. The exhibits show a great deal of activity concerning this loan; the trust company made no effort to repay it, and the same may be said of the railway company.

Their third communication to the minister (ex. 3, p. 15), deals with a loan to C. A. Barnard, who had become a director of the bank, and concerning whose election the western directors protested, as above referred to. It sets out that from the report of the inspector of the Toronto office made in June, 1915, it appears that C. A. Barnard was indebted to the bank in the sum of \$394,000, and that 2,622 shares of Home Bank stock were held in the name of Barnard and Pellatt in trust. The inspector pointed out that there was no trust deed held concerning these shares, and that they would have to realize about 125 per cent to enable the bank to avoid a loss. It will be shown a little later that in addition to these three large amounts other individuals and companies were shown to be indebted to the bank in sums wholly disproportionate to the bank's assets, but in their first communications the western directors called the attention of the minister to these three large accounts then representing more than the whole paid up capital of the institution. They complained as to the Barnard loan that they never could get any satisfactory explanation of the transaction; that it had been explained by Col. Mason at the November meeting in 1915 that it was connected with the taking over of the Banque Internationale, but how it came to be made or what its object was, complainants say they could not ascertain; neither could they understand, nor were they informed, as to the relationship of the bank shares to the loan in question; and by the submission of these three accounts and others mentioned in the exhibits, they brought the attention of the department to the condition of the bank. I do not conceive it to be my duty to enter into detailed history or explanation concerning these loans; I am answering the question as to what the representations were, and it is apparent that the existence of three accounts, viz: the Prudential Trust Company, C. A. Barnard, and the A. C. Frost Company, involving at that time the withdrawal from circulation of over two and a half millions of dollars of the bank's funds (ex. 4, p. 16, and 35 p. 59), upon which no interest was being paid, and to some of which addition was being made from time to time, was relied on by the western directors in their complaint against the bank management. They further showed that by a statement placed before the board of directors at the meeting in September, 1915 (ex. 4, p. 17), the Barnard account and the Prudential Trust Company account, and other accounts mentioned below, had been increased from December 31, 1914, and August 31, 1915, in the amount of \$192,849.30. Increases involved in the A. C. Frost Company account and the Pellatt & Pellatt account were responsible for the greater part of this sum and except incidentally in the statement of increases mentioned above, the indebtedness of the last named firm was not placed before the minister in the year 1916. This branch of question number 1 is two-fold:—

First, as to what representations were made in 1916; and,

Second, what representations were made in 1918. Coming now to the representations made in the year 1918, it will be observed that everything that was placed before the department in 1916 was still available, as well as an addi-

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tional representation contained in the letter of Mr. W. A. Machaffie, who signed himself "Late assistant to the president"; and under date of August 29th, 1918 (ex. 88, p. 178) communicated certain very important facts concerning the condition of the bank to the then Minister of Finance, by registered mail. He drew the reports of Mr. Fisher, made in February, 1916, to the Minister's attention, and also referred to the A. C. Frost account—which will be mentioned below—as well as to certain shipbuilding transactions in which he alleged that the bank, as well as the president and one of the directors, were interested with a Mr. Stewart whom he described as a personal friend of Mr. Haney, the vice-president; he made the serious charge that the dividends which had been declared during the years 1916 and 1917 had been based on the addition of interest to doubtful accounts; that section 153 of the Bank Act had been violated; and that Home Bank officials, unwilling to share in what he termed the "guilt" of making false returns, were obliged to resign; that the auditor who had the affairs of the bank under examination was incapable of filling that position; that information was withheld by the officials of the bank from their counsel, Mr. Lash. Taken as a whole, the nature of this communication was such as to cause the liveliest apprehension concerning the financial standing of the bank, and concerning the safety of the funds entrusted to it, if even only a portion of such representations were true. And from the particulars furnished to the Minister by officials of the bank in response to his demand for information bearing upon the accounts referred to in the communications sent to him, it appeared that the indebtedness of the Prudential Trust Company to the bank on the 15th of November, 1918, had risen to the sum of \$933,747.74 (ex. 107, p. 194). This large increase was due, for the most part, to a further expenditure, the object of which was to protect the original investment, but which in 1918 gave little promise of assisting to work the account out. The account of A. C. Frost & Co., sometimes referred to as the British Columbia timber account, was reported on 30th November, 1918, as an indebtedness of \$2,425,288.58 (ex. 108, p. 200). The Pellatt & Pellatt accounts showed that \$1,900,960.69 of the bank's funds were locked up therein (ex. 109, p. 201). A portion of these capital sums represents interest on the original investment, and the bank's statement to the Minister also revealed the disquieting fact that unpaid interest amounting to \$688,962.42 on the Frost account and \$234,955.11 on the Prudential Trust Co. account, had been added to the principal and taken into profits (ex. 107, p. 195).

It was therefore abundantly clear that the management of the bank had resulted in an amount over twice its paid-up capital and reserve being locked up in accounts not realizable, and for the most part not bearing interest, from which it followed that whatever funds were available from day to day were those of the depositors, and notwithstanding the declaration of dividends, a proper accounting would have shown that no profit at all had been made for years. The bearing of these facts upon the condition of the bank is specifically enquired of in the next quotation and will, I think, be more properly considered thereunder.

Answer to question number 1:—

A. In the year 1915 no representations were made to the Department of Finance of the Dominion of Canada respecting the condition of the Home Bank of Canada. Such representations were made in the year 1916, as well as in the year 1918.

B. The following important representations were made to the Department of Finance concerning the condition of the Home Bank during the years 1916 and 1918, viz:—

(1) That an amount more than double the total paid up capital and reserve of the bank was locked up in four accounts, the securities for which could not be realized upon.

(2) That loans wholly disproportionate to the assets of the bank had been made on inadequate security, from which large loss was likely to occur.

(3) That amounts representing unpaid interest on at least three large accounts were carried into profit year by year and dividends declared on the basis of much fictitious earnings.

(4) That arrangements agreed upon at a meeting of the board of directors with a view of passing upon all credits and making an early statement showing the bank's position, with recommendations, were not carried out.

(5) That false returns were made by the directors of the bank to the Department of Finance.

(6) That specific instructions given by the Minister of Finance in 1916 forbidding the capitalizing of unpaid interest, were disobeyed.

(7) That the president and some of the directors were indebted to the bank in large sums upon personal account and through companies in which they had an interest.

(8) That the auditor employed by the bank from year to year was incompetent and important matters were concealed from the board of directors and from Mr. Lash the bank's counsel.

Question number 2 reads as follows:—

"Whether, if such representations were made, a state of affairs was revealed concerning the condition of the said bank such as would have justified an investigation under the powers conferred upon the Minister of Finance by section 56A of the Bank Act."

Argument was presented in support of the proposition that the minister is responsible to parliament alone, and that unless he were charged with dishonesty or bad faith in the performance of his duties, the exercise of his discretion could not be challenged by this commission. I am not disposed to dispute this contention, seeing that the only duty imposed upon me under this question is to say whether the representations made to him were such as to justify him in calling for an audit under section 56A of the Bank Act.

I am not called upon to question the manner in which he made use of the powers therein given to him, nor whether he exercised his discretion correctly or otherwise. It is easy to conceive that certain representations might be made to a minister which would be of such a nature as not to call for the exercise of the rights given to him by this section of the statute, while on the other hand it is equally obvious that other representations might be made of a character which would not only justify the exercise of his discretion, but would make it a matter of careless administration if he should not do so. How such discretion should be exercised is a matter by itself, and must be for the determination of the head of the department. If any fault is to be found with the minister as to how his discretion was exercised, the complaint must be tried before parliament itself, always assuming honesty and integrity of purpose on his part, and no question whatever was, or could be, raised in that regard. But it is open to me I conceive, to say whether such a state of affairs was revealed as would call for the exercise of the discretionary powers vested in the minister. In answer to the preceding inquiry, I have detailed the representations which were made, and, taking them as a basis for my answer to this question, I do not think that any doubt can be entertained that what had been so represented was of sufficient importance to call for an audit under section 56A of the Bank Act. I am in harmony with the view of Sir Thomas White, as shown in his evidence at page 345 of the record:—

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"Q. As a result of the memorandum and other documents filed with you by Mr. Fisher, you proceeded under section 113 of the Bank Act to ask for a report?—A. I did.

Q. You also decided that it would justify an investigation under section 56A?—A. I asked the auditor to make a report to me.

Q. That is under that section?—A. Yes, 56A, without doubt I proceeded under the Bank Act.

Q. Well, you might answer my question, you felt yourself justified in asking for a report under section 56A of the Bank Act?—A. Yes, undoubtedly, and calling on the board and on the auditor.

Q. Did you call on the auditor for a report under section 56A of the Act?—A. Right."

It will be remembered that in his argument Sir Thomas White contended, with reference to the evidence above quoted, that in answering these questions as he did, he was not committing himself to the view that an outside auditor should have been called in, but that he was confining his testimony to an assent on his part that the auditor appointed by the shareholders should make report, and he said that if the questions had been put to him plainly as to his being justified in calling in an outside auditor, he would have answered them in the negative, for the reason that, in his opinion, the conditions prevailing in the bank at that time would have meant that calling in an outside auditor would have necessitated closing its doors.

The powers given under section 56A of the Bank Act, as it stood in 1916, were not confined to the employment of an outside auditor, or to the employment of the regular bank auditor either. The provision was to the effect that the minister could direct any auditor "to examine and enquire especially into any of the affairs or business of the bank", and the argument was, that an auditor wholly detached from the bank should have been selected, whereas the minister, in the exercise of his discretion, for the reasons indicated, thought best to appoint Mr. Jones, the regular auditor of the bank. There is no necessity for the expression of any opinion upon my part as to whether the minister should have engaged an inside or an outside auditor for this work; either one could be appointed by the minister under that section according to his discretion and the evidence above quoted shows that the minister exercised his discretion under the section in question by the appointment of Mr. Jones. It must therefore follow that to his mind the conditions prevailing justified the investigation under the authority of section 56A of the Bank Act, altogether apart from the question whether it should be made by one class of auditor or the other. The enquiry up to this point, has, I think, brought us to the conclusion that the reason that an outside auditor was not appointed was that the minister feared such action would result in the collapse of the bank. It is not said by anyone that the exercise of the powers given by section 56A were not or should not, have been called into action. The argument put forward by counsel for the shareholders was, that such discretion as the minister saw fit to exercise was really useless. The statement that an outside auditor would have closed the bank, throws some light upon that contention.

The letters which passed between Sir Thomas White and the president of the bank and Mr. Lash and others, show that it was with considerable reluctance that the minister relinquished his first idea of calling the attention of the Bankers' Association to the condition of the bank, but that he was moved thereto by representations of a betterment of condition by change of management, and by statements made by Mr. Lash, in whom, it is unnecessary to say, he reposed a very great deal of confidence; but inasmuch as it is admitted that these representations resulted in calling upon the auditor of the bank under sec-

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tion 56A, it is hardly necessary for me to amplify reasons which have led me to the conclusion that the state of affairs revealed by the representations made, justified an investigation under the powers conferred upon the minister by section 56A of the Bank Act, for what the minister did shows it. That he considered the situation to be a serious one, is evidenced by his letter to General Mason, then the president of the bank, written under date of January 24th, 1916, (ex. 43, p. 75), immediately after receiving the complaint of the western directors through Mr. Fisher. It will be remembered that these representations and complaints were not made by outside people, or by individuals to whom some personal grievance or antagonism towards the bank could be attributed; they emanated from persons bearing the responsibility of the institution, being directors, entrusted by their shareholders with seeing that an honest management prevailed. In this letter the minister said that he considered it his duty to ask for full particulars, both from the board and from the auditor, as to the accounts of the Prudential Trust Company, Pellatt and Pellatt, and A. C. Frost and Co., with a detailed statement of securities held. In answer to a letter received from the president, asking the minister if he would have the thirty days referred to in section 113 of the Bank Act to make such return, the minister advised him that the matter was of so serious a character that he thought it advisable that the reply should be completed and forwarded at as early a date as possible.

In writing to Mr. Fisher upon the subject, (ex. 54, p. 86) Sir Thomas further said:

“You make certain definite explicit charges, which I conceive it to be my duty to investigate.”

This latter sentence describes the effect produced upon the minister by the communications.

The evidence discloses that after the receipt by Sir Thomas White of the communications from the western directors, attempts were made to change the management of the bank so as to meet with the approval of all the directors, and such attempts were well known to the Minister of Finance, being conducted mainly through the late Mr. Z. A. Lash, K.C., who had personal interviews and carried on correspondence with the minister concerning the matter. But notwithstanding the desirability of having the whole directorate in accord, Sir Thomas White did not consider that to be a solution of the difficulty, and defined his position in a letter of February 17th, 1916, written to Mr. Lash in these words: (Ex. 71, p. 162.)

“*Sir Thomas White to Z. A. Lash.*

“*Re Home Bank of Canada:*

“DEAR MR. LASH:—I have your private letter of the 14th instant and think I must ask you for the statements to which you refer. In themselves they may disclose a situation which apart altogether from the question of other accounts would cause me to bring the affairs of the bank to the attention of the Bankers' Association through its president here. The position is that I have been made aware by the Winnipeg directors of a certain condition which is most disturbing. It does not appear to me that I would be justified in staying enquiry because the Winnipeg directors may ask me to suspend action. The real question is whether the bank, having regard to the condition which will be disclosed by the statements should be allowed to continue business with the public. I shall be glad, therefore, if you will send me those statements. It would

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not appear to me necessary that you should specially come down about the matter but I leave this to your discretion. I shall desire, of course, to give the reorganized board and management every opportunity to restore the bank's position, but this statement must be taken subject to the overriding consideration of the public interest."

This was the view taken of the matter by the minister both in 1916, and two years later, when his attention was again drawn to it by Mr. Machaffie's letter. The serious character of the representations made therein was appreciated by the minister, as shown by his letter to Mr. Lash under date of September 4th 1918. He enclosed a copy of the Machaffie letter and asked Mr. Lash to take the matter up with the board of directors, and expressed himself as follows:— (ex. 90, p. 179).

"Sir Thomas White to Mr. Lash.

"I regard the matter as of the utmost public importance, and it is my intention to have a thorough investigation made through the Bankers' Association or otherwise. Before taking this step, however, I wish to have a reply from Mr. Hancy and his board."

All I am at present directing my attention to is, whether or not the representations made would have justified an investigation under section 56A of the Bank Act. From the testimony above quoted, and from the letters, extracts from which are set out above, it is very apparent to me that the representations made were regarded, on all sides, as of a character which would justify such investigation, and, I thoroughly agree with that view.

Answer to question 2:—

The condition of the bank, as revealed by the representations made, was such as to justify an investigation under the powers conferred upon the Minister of Finance by section 56A of the Bank Act.

Question number 3 reads as follows:—

"What action, if any, was taken by the then Minister of Finance, upon such representations as may have been made."

It is apparent that the answer to this must be shown by the communications which passed between the minister and the bank and parties in interest. They disclose in the first place, a lively apprehension on the part of the minister concerning the position of the bank, and a desire to keep it upon its feet.

Confining myself first to the year 1916, it is evident that the minister acted promptly on the receipt of the three memoranda from the western directors, for on the 24th of January, 1916, he addressed a letter to the president of the bank, detailing the information submitted to him by Mr. Fisher and the complaints made. After referring to the accounts of the Prudential Trust Co., Pellatt & Pellatt, and the A. C. Frost Co., the safety and security of which were challenged, the minister concludes his communication to the president of the bank as follows (ex. 43 p. 76)—

"Sir Thomas White to James Mason.

"I shall be obliged if you will write me officially, setting out concisely the history of these loans and indicating the amounts of unpaid interest (if any) in such accounts. I also request a detailed statement as to the securities held as collateral and the valuation placed upon them by your bank. Apart altogether from the question of security, the loans appear to me to be exceedingly large, having regard to the capital of your bank."

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and I can only express the hope that the concern which is undoubtedly felt by the directors mentioned may prove to be unfounded. In directing to you this letter with reference to the memorandum which, as I have stated, has come before me officially, I am following the practice which we have hitherto adopted in similar cases and am acting under the provisions of section 113 of the Bank Act."

On the same day the minister addressed a letter to the auditor of the bank, Sydney H. Jones, enclosing a copy of the letter which he had sent to the president, as follows: (ex. 46. p. 78.)—

"Sir Thomas White to Sydney H. Jones.

"The Home Bank of Canada.

"For your information I enclose herewith copy of a letter I have today addressed to Hon. James Mason, president of the above bank, referring to a memorandum which has been officially filed with me respecting certain accounts of the bank and requesting detailed information.

Under the provisions of section 56A of the Bank Act, I now direct and require you as auditor to enquire into the accounts mentioned and report to me in all proper detail respecting them. Your prompt attention will greatly oblige."

Mr. Jones acknowledged the receipt of this letter on the 26th of January 1916, but, further than that, he seems to have paid no attention to the directions sent him by the minister, who again addressed him on the 24th of the following month as follows:— (ex. 59. p. 89.)

"Sir Thomas White to Sydney H. Jones.

"Re Home Bank of Canada.

"Referring to my previous letter requesting an investigation by you of certain accounts of the above bank, I shall be glad if you will send me as soon as possible a detailed statement showing advances, repayments, and interest charges on the A. C. Frost Company account. The western members of the Board have thought it desirable that I should obtain this information. Your prompt attention will oblige."

This communication was acknowledged by Mr. Jones on the 26th of February 1916, and on the first day of March following he forwarded a statement showing details of advances, repayments and interest in the A. C. Frost Company account, which he said that he had duly verified by the books of the bank. (Ex. 61. p. 90.) This is all that was done by the minister or the auditor under the provisions of section 56A of the Bank Act.

It is apparent that the minister relied with confidence upon the opinions expressed by Mr. Lash, counsel for the bank, and accepted his conclusions. The result was, that in consequence of the representations made by Mr. Lash and the directors, acting then in harmony, Sir Thomas consented to allow them to work the situation out, but in assenting to this it is plain that the mind of the minister was hardly at rest and his opinion concerning the condition of affairs can easily be gathered from his letter to Mr. Lash as follows: (Ex. 84, p. 175).

"Sir Thomas White to Z. A. Lash

"I have yours of the 23rd inst., in which you set forth substantially what occurred at our interview on Wednesday. You clearly understand that I reserve to myself the fullest liberty to consult with the president of the Canadian Bankers' Association, or take any other steps which I may deem to be in the public interest without further communication

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with Mr. Haney or yourself on the subject. In the meantime it appears to me from the statement of yourself and Mr. Haney and from Mr. Crerar's letter that the position of the bank is being improved. I should like to have from you an assurance that interest upon the Frost account will not be taken into profits distributed to shareholders in the way of dividends. It would appear to me also that until the New Orleans situation is cleared, it would be advisable to pursue a similar course respecting that account."

Within a week from the receipt of the letters from Mr. Fisher, the minister had interviews with Mr. Haney, vice-president of the bank, and Mr. Barnard, then a director (ex. 51, p. 80), whose dealings with the bank were criticized, and impressed upon them the necessity of bringing pressure to bear on the doubtful accounts, and the danger of showing unpaid interest as profit. This was followed by communications to the minister from Mr. Fisher, K.C., and Mr. Lash, K.C., and a communication from J. Cooper Mason, acting general manager of the bank, to the minister, enclosing papers and documents showing in full the statements of the accounts which were challenged (ex. 63, p. 93). All these communications were written and information supplied within four weeks from the time of the receipt by the minister of the complaint from the western directors, which shows that no time was lost on his part in an effort to secure the necessary information. The correspondence shows that the minister was not convinced that, because the eastern and western directors had settled their difference, he should stay his hand from a thorough and complete investigation of the bank's affairs (ex. 71, p. 162). But further correspondence carried on by Mr. Lash and Mr. Crerar, and personal interviews with the two latter as well as with Mr. Haney, and information furnished concerning the accounts—much of it misleading and false—and promises of a thorough investigation of the bank's affairs under the direction of Mr. Haney and Mr. Machaffie, and information supplied by both these gentlemen (ex. 83, p. 172) and the minister's desire to prevent the collapse of any bank in view of war conditions, resulted in his acquiescing in the unanimous request of the whole board that no investigation should be made. No other report from the auditor was asked for or received. It was represented to the minister, in a letter signed by Mr. Crerar (ex. 81, p. 171) that a change in management had taken place by which he expressed himself certain that the knowledge and information concerning the position of affairs desired by the western directors, and the changes they wished when they sent their request to him, could now be made without calling in outside assistance; that the situation had materially improved within the past month, and that it was better to have the inquiry proceed from within rather than from without.

If the information thus furnished to the minister concerning these accounts had been accurate, I think it is reasonably clear that the course adopted was in the interest of everybody, including the depositors; but it is difficult to conclude that they had made a full disclosure to the minister concerning the situation which Mr. Lash described by letter written on the 29th of February, 1916, to Mr. Fisher, in these words (ex. 132, p. 292):—

"Z. A. Lash to James Fisher

"The more I consider the bank's position, even assuming that every account will ultimately be collected in full, the more doubtful I feel as to the possibility of its continuing in business. The amount locked up indefinitely in four large accounts, is probably three times the paid-up capital, and more than half the total deposits; and if anything should take place which would cause a comparatively small percentage of the depositors to ask for their money, I do not see how the bank would, without assistance from outside, continue with open doors

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"I told Sir Thomas that my main object, since I learned in outline what the bank's position was, has been to bring about a position, which, if the worst happened, would result in liquidation with open doors. This can only be brought about by the assistance of other banks, and I want definite instructions from the board as to how far I may go in this direction in consultation with Sir Thomas White, for he is now an essential element in the situation, which cannot be disregarded. He told me and I could not dispute the correctness of his position, that, after you, on behalf of the Winnipeg directors, had submitted to him information which, to say the least, was very disturbing, the responsibility was thrown upon him, which he could not avoid, and which would not be discharged because those who had invited his intervention might desire him to withhold further action."

Attention may be drawn here to the fact that this communication was not addressed to Sir Thomas, nor is there any evidence that he was in possession of Mr. Lash's views as above expressed. Following the representations above referred to, the hand of the minister was stayed, no inspection was ordered, and the audit, if it can be called such, was useless.

Attention was drawn by Mr. Lafleur, of counsel for the Government, to the unwisdom of seeking information from the parties whose good faith was challenged, and he strongly urged that the only proper course to have pursued would have been to have sought information from an outside source. I am not asked to comment on the course taken by the minister, but simply to say what he did. It is open to all concerned to draw whatever inferences the circumstances would seem to justify in that regard.

Upon receipt of the complaint, in 1916, the first action taken by the minister was to direct an enquiry into the accounts complained of, and a report thereon by Mr. Jones, the bank's auditor, under section 56A of the Bank Act. (ex-46-p-78). And at the same time he called upon the president of the bank for special returns under the provisions of section 113 of the Bank Act. (ex-43-p.75).

Turning to the consideration of what was done by the minister in 1918, when further complaint was made, it is clear that upon the receipt of the letter from Mr. Machaffie, dated the 29th of August 1918 (ex-88-p-178), the minister lost no time in communicating its contents to Mr. Lash, as appears by his letter dated September 4th 1918, in which he enclosed a copy of Mr. Machaffie's letter to him, and asked that it be taken up with the board of directors and a report be made. The letter reads as follows:—(ex-90-p-179).

"Sir Thomas White to Z. A. Lash

"Re Home Bank

"DEAR MR. LASH,—I enclosed herewith copy of a letter which I have received from Mr. Machaffie, late assistant to the president of the above bank. I shall be glad if you will take the matter up with the board of directors and have a report prepared dealing with the several charges made. I regard the matter as of the utmost public importance, and it is my intention to have a thorough investigation made through the Bankers' Association or otherwise. Before taking this step, however, I wish to have a reply from Mr. Haney and his board."

Absence of Mr. Lash and illness of Mr. Haney seemed to be the cause of a delay in forwarding the board's reply to the charges made by Mr. Machaffie, but it was eventually sent to the minister under date of October 29th, 1918. (ex-96-p-182). The report is a voluminous one, touching upon all of the doubtful accounts, denying the charges contained in Mr. Machaffie's letter, and

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picturing a condition of affairs with reference to the bank, which, if true, would have disproved the necessity of action being taken. It is in the form of a resolution of the board of directors, dealing with all the matters complained of by Mr. Machaffie, and signed by the president. The regrettable thing about it is that in very many respects it was not true. But its receipt seems to have satisfied the minister that the proper course to be taken under the circumstances was to allow the bank officials to work out the situation. Having said so much about Mr. Machaffie's letter, it is right, I think, for me to say, that its force in anybody's mind would very naturally be broken by the fact that on the 25th of February, 1918, Mr. Machaffie had drafted a letter to the Minister of Finance (ex-135-p-390) in which he made representations concerning the Pellatt account, the New Orleans account, and the Frost account, commenting adversely upon them, and saying that there were numerous other accounts in a precarious condition, and sharply criticizing the policy of the president, Mr. Hancy. This letter was not sent to the Minister of Finance, but a copy of it was forwarded to the Home Bank. (ex-146-p-402). Mr. Machaffie subsequently retracted all these statements in a letter to the bank, admitting that his information was inaccurate and incomplete, and that his first letter would have conveyed a wrong impression as to the condition of the bank and the conduct of its affairs. Now the minister was acquainted with the fact of this withdrawal, and that the reason Mr. Machaffie had retracted these statements was, that he might procure a settlement of his claim against the bank. If the accuracy of the information concerning the banks' affairs had depended upon Mr. Machaffie's representations, while perhaps it would be too strong to say that no attention whatever should have been paid to him, yet the fact remains that he had retracted them under circumstances that would very materially weaken them, and would also present their author in a very unfavourable light. If it were a question between Mr. Machaffie and the officials of the bank, backed in their statement by Mr. Lash, no one would expect otherwise than that Mr. Machaffie's statements would be ignored. In response to the minister's call for a report upon the matters, there was submitted to him under date of 29th October, 1918, a lengthy statement signed by the president of the bank, in the form of a report unanimously adopted by the board, instructing the president to forward a copy to Mr. Lash, and with a direction to have the same forwarded to the minister. (ex-96-p-182). The report made reference to what was done in 1916, and the changes made since that time in the management of the bank, discussed the accounts which had given so much trouble, and reported favourably on the British Columbia account, and the New Orleans account; it denied that any dividends had been paid out of capital, and asserted that the profits of the bank actually earned had been sufficient to warrant the payment of the dividends; it set out the net profits for the years 1917 and 1918, and controverted Mr. Machaffie's statements about the shipbuilding enterprise, on which he had commented unfavourably; it assured the minister that the position of the bank had been steadily growing stronger, giving figures of its growth comprising the years 1917 and 1918, and at great length purported to set out the improved position of the institution. It was a report of such a character as to set at rest the mind of anyone who believed it, and apparently was written with that end in view. Upon its receipt the minister apparently was convinced that there was no necessity for ordering any further investigation. It was so drawn as to raise an issue between Mr. Machaffie and the president and directors of the bank, thereby clouding the real question.

Answer to question 3:—

The action taken by the Minister of Finance upon the representations made to him consisted in:—

(a) Calling for special returns from the bank under section 113 of the Bank Act.

(b) Calling for a report from the bank's auditor under section 56A.

(c) Seeking and obtaining information from Mr. Lash, the bank's counsel, and from its president and other directors, including therein detailed statements of accounts regarding the dealings of the bank with the following individuals and firms, viz: A. C. Frost & Co.; Pellatt & Pellatt; the Prudential Trust, New Orleans account.

(d) Forbidding further capitalization of interest on doubtful accounts.

(e) Securing a promise from Mr. Lash and the president that a thorough investigation would be made of the affairs of the bank under the direction of Mr. Haney and Mr. Machaffie.

I think it is right to say also that the minister's intervention in 1916 resulted in a change of management of the bank, Mr. Haney becoming vice-president, with the understanding that he should discharge the duties of president, and have full powers with respect to the organization of the staff; this change appears to have met with the approval of all concerned, although no improvement seems to have actually resulted from it.

Question number 4 reads as follows:—

"What effect would an audit under section 56A of the Bank Act, if made in 1915, 1916 and 1918, have had upon the conduct of the affairs of the said bank and upon the position of the present depositors."

Confining myself to the years 1916 and 1918, as no evidence whatever has been directed towards the year 1915, it is clear that an effective audit would have revealed a condition of affairs demanding the application of immediate and drastic remedies. It will be noticed that both in his evidence and in his argument Sir Thomas White directs attention to the fact that he called for an audit of certain accounts under the above mentioned section of the Act, and the criticism of the other counsel was, as outlined in the answer to question 2, that he directed the auditor of the Home Bank to do the work, instead of selecting an outside auditor or one named by the Bankers' Association, as he had first in mind. It is apparent that he received no such audit, and at page 346 of the evidence he thus describes it, in answer to questions put by Mr. McLaughlin:—

"Q. So while you directed the audit under section 56A you never received one?—A. I received an audit of the Frost account.

"Q. Just the statement from the ledger?—A. Well, that is what appears in these exhibits. It is not in my mind that I received anything else, but I may have. But I do not say I did.

"Q. There is nothing else in the exhibits. That of course was not the kind of independent audit that these directors wanted?—A. Not up to a certain stage, up to a certain stage they wanted an independent audit.

"Q. And this was the auditor who had certified to the various reports of the bank from year to year?—A. Yes.

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“Q. So to ask him for a further statement would be to merely ask him to send in his previous report or else show he was wrong?—A. I do not think so, the previous report dealt with general accounts. I asked him for a report in all fitting detail.

“Q. Anyway, the report was never received, except this?—A. Apparently not.”

The evidence of the minister is to the effect that had he known the true condition of affairs in 1916 or 1918 he would have taken steps to meet the situation. The steps indicated by him were, that by calling in the aid of the Bankers' Association, arrangements could have been made to have the bank taken over by another institution. Even if, for reasons that might be imagined, this could not have been consummated, I think a revelation to the stockholders of the existing condition of affairs could have had no other result than a complete change of management. Anyone whose funds were at stake must instantly have realized the necessity of forcing the liquidation of the large accounts, whose inactivity was gradually drying up the resources of the bank. It is impossible to state with certainty what would have occurred in any line of business, had certain events intervened, and what renders an estimate in that regard most questionable, is the fact that one's mind and opinions are liable to be influenced and shaped, even unconsciously, by events subsequent to the period which is under consideration; consequently the value of an answer to a question of this nature must for that reason be impaired; but notwithstanding all this, one can always rely in judgment upon the continued operation of natural impulses for safety which prevail in financial dealing. It is a fact that disclosure of the true financial condition of the bank in 1916 and still more in 1918, would have shown that, under the management of the then board of directors, the bank had been placed in most extreme jeopardy; that they, and others associated closely with them in its affairs, had access to the resources of the institution to a degree wholly incompatible with the bank's financial standing; that the capital had been most seriously impaired, if not altogether lost, and fictitious earnings were being put into profit and loss account as a justification for declaring dividends which had not been earned, and in view of these facts I think it can safely be said that the effect of an audit of the bank's affairs in 1916 or in the year 1918, would have been to bring to the attention of the shareholders a condition of affairs which would have moved them instantly to insist upon a change of management, and to have wholly reversed the policy theretofore pursued. It is inconceivable, I think, that the permission of the Department of Finance, or of the shareholders of the bank, could have been procured to countenance the continuation of the then conduct of the bank's affairs, as must have been disclosed by a thorough and effective audit. It might have come to pass that the minister, after such audit, would have been able to secure the amalgamation of the Home Bank with another bank. If that desirable course could not have been effected, the bank would have come under honest management, and in my view, been compelled to liquidate its affairs; for after disclosure of its true condition, as must have followed an effective audit, there would inevitably have been an instant demand by the depositors for their money, and a withdrawal of public support generally, which, in view of the condition of the large accounts, and the impossibility of converting them into liquid assets, must, I think, have resulted in liquidation.

I now turn to the second branch of this question, which asks:—

“What effect such audit would have had upon the position of the present depositors.”

In answer to this I may say I am taking it for granted that such audit would have been thorough and effective, and as observed above, I think the result would have been either to close the bank altogether, or put it upon a firm foundation as an integral part of another banking institution, since, for the reasons above noted, I do not think it could have had further independent existence. In the light of this supposition, it is obvious that as far as the year 1916 is concerned, such audit would have saved the situation for the then depositors, for although the capital and reserve had largely, if not wholly, disappeared, yet despite the loss thus made, there was still left a fairly balanced account, according to the testimony given by Mr. Edwards.

There is no evidence as to what number of those who are referred to in the question as "present depositors," occupied that position in 1916 and 1918; but I think it is clear, as regards those who were depositors in the first named year, that if either of the foregoing remedies had been applied, their accounts would have been met in full from the then resources of the bank, backed by the double liability of the shareholders, and it is this last asset which might have saved the situation for the depositors in the year 1918.

It is my duty to specifically inquire into the financial condition of the bank during the years 1916 and 1918 under the next succeeding question, and the result of that inquiry is closely bound up in the answer to the present one; but my finding on this branch of question 4 is that an effective audit in 1916 would have resulted in action which would have saved the depositors from loss. While, because of lack of evidence on which to base a conclusion, it is impossible to speak with as much certainty as regards the year 1918, the probability is that the same result would have followed had the audit been made and action taken in that year.

Answer to question 4:—

For the reasons above set out, I think an effective audit under section 56A of the Bank Act made in 1916 or 1918, would have resulted, as far as concerns the conduct of the bank's affairs, in either:—

- (a) Liquidation immediately following such audit, or,
- (b) Amalgamation with another bank.

And the effect of such audit upon the position of the present depositors:—

If made in 1916 the present depositors would have suffered no loss.

If made in 1918, I do not think any loss would have fallen upon them.

Question number 5 reads as follows:—

"What was the financial condition of the said Home Bank of Canada in the years 1915, 1916 and 1918 respectively, and what steps, if any, could have been taken by the Government to save the situation?"

The returns to the Government for 1916 show (ex. 170, p. 495) that the paid-up capital of the bank was \$1,946,639; the reserve, \$300,000; the deposits, \$10,028,224; the total liabilities were \$18,722,963; and the total assets \$21,030,353. Upon this showing a dividend of five per cent was declared and paid. The foregoing figures indicate an excess of assets over liabilities of \$2,307,390, which represents what the officials of the bank reported to the Government in that year as to the financial condition of the Home Bank of Canada. The expert accountants, Mr. Clarkson and Mr. Edwards, who testified before the commission, were undoubtedly best equipped to find the answer to this question. Whatever lack of unanimity there is in the opinions expressed

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by these two gentlemen, arises from a difference as to what would have been their respective opinions if confronted by the physical assets of the bank in 1916 and asked at that time to pronounce upon their value. If the answer to the question—what was the financial condition of the Home Bank in 1916—depended wholly upon ascertaining what value should be placed upon the bank's assets in the year indicated, I think that is a most difficult thing to determine. Confining attention for a moment to the large accounts which were challenged, it seems to me that the one concerning which an auditor at that time would have spoken with most certainty, was the Prudential Trust account, spoken of as the New Orleans account. The bonds, which were security for the loan, had become worthless by the underlying property having been disposed of under a prior claim, and it looked as if a total loss would be made in that particular, and yet, to illustrate the difficulty of relying upon opinions thus formed, it is only necessary to say that at present, Mr. Clarkson holds out strong hope of this account being paid in full, that result having followed from further expenditure for the purpose of protecting the claim. An estimate of the value of the security underlying the loan to A. C. Frost & Co. in 1916 must have been influenced by the reports on these timber limits, then on file in the offices of the bank, as well as from reports of two of the directors who had personally visited the locality and pronounced favourably upon it. A like remark may be made as to the Pellatt & Pellatt loan, and while both these latter have turned out much more disastrously than could have been anticipated, they nevertheless, in the year 1916, could not have given to an auditor anything like the concern which now prevails regarding them. Again, the wisdom of adding interest to an existing loan and carrying such interest into profits year by year, as far as the safety of the investment is concerned, must depend upon the value of the underlying security, and that remark I think has a bearing upon what conclusion an auditor in the year 1916 would have drawn as to the financial condition of the bank from the standpoint of its physical assets represented so largely by the existing securities for these large loans. I can draw only lame conclusions in view of the reports which would be laid before the auditor in 1916. Clearly an auditor could not have taken it upon himself to have personally valued the timber lands, nor indeed to have gone over all the properties and securities represented by the Pellatt loans or the New Orleans Railway loan, but looking at such information as was available for him in the year 1916 with reference to the securities underlying these large loans, and speaking from the standpoint of that year, it is difficult to say what value should have been placed upon these assets in 1916, and consequently what its financial condition was viewed from that standpoint. If estimated in the light of knowledge since acquired, the answer is easy. But I think there were easier tests to apply, which were open to his observation, and would have challenged the attention of any competent auditor. One of these lies in the power of the bank to earn and pay dividends from year to year. While from the standpoint of abstract security as manifested by the reports available, I think it could hardly be said at that time, that the capitalization of interest on these accounts would necessarily be productive of danger, yet considering that such course resulted in depriving the bank of its liquid assets available for dividends as well as for daily use, I think these accounts were calculated to cause the liveliest apprehension. It is just as necessary that a bank be in a position to marshal its assets for the purpose of a dividend as that its solvency be manifest from a comparison of its general liabilities and assets, and having regard to the capital and resources of this bank, the capitalization of interest on these large accounts from year to year must have been looked upon as a most dangerous and alarming procedure. And I think it would be equally correct to say that the existence of these accounts them-

selves, which rendered it necessary to capitalize the interest, was a most disturbing circumstance apart from the question of securities held for them. The effect of a bank passing a dividend is too well known to require comment. Conditions may be imagined in which directors would wisely determine it to be better to pay the ordinary dividend, even though the profits were unliquid, as in the case of this bank; but, before another year should elapse, unquestionably steps should be taken to force the liquidation of accounts rendering that course necessary, otherwise the result would be as in the present instance.

Also, there is always an existing danger that for some reason or other a run upon a bank's funds may take place for which a volume of ready money is necessary to tide over the situation. Whether any cause exists justifying such action is beside the point. It does occur from time to time that depositors become alarmed, frequently for no valid reason, and in consequence of such alarm demand their money. No bank should lose sight of the possibility of such an incident taking place, and be prepared to meet it. From that point of view it is unnecessary to argue that these accounts then carried by the Home Bank were altogether incompatible with safety, and I think that any competent auditor would have felt compelled to so report. Here again it will be perceived that this has no direct bearing upon the sufficiency of the security for the principal and interest of the loan, but the existence of these large loans was, in my opinion, wholly contrary to sound banking principles, for the two reasons briefly outlined above, and therefore that they created a very dangerous condition for the bank. Now for these reasons, rather than from the comparison of assets and liabilities, I think a competent auditor, viewing the situation in 1916, would have felt compelled to report an extremely dangerous situation in connection with the bank, for it was apparent that dividends were being paid out of interest which had been capitalized; in other words, from earnings which were not available, and he would have been confronted by the ominous fact that the amount of interest so capitalized and taken into profits then amounted to much more than the whole capital and reserve of the bank. He would have seen that during the year 1915, although a profit of \$163,900 was shown, the actual state of affairs was that there had been taken into profits uncollected interest on four accounts to an amount exceeding \$275,000; (p. 270) that in the year 1916, in which a profit of \$133,406 was shown, uncollected interest to the amount of \$210,000 (p. 271) had been put to profit account. Now the necessity of taking these uncollected annual amounts into profit and loss in order to declare a dividend, would have given to an auditor most serious concern, apart altogether from the question whether the security available for each individual account could have stood the strain of the additional interest as well as the principal which it professed to guarantee. No doubt an auditor would have been very much embarrassed by finding these large accounts in the condition in which they were, and must have reported them with such comments as in his judgment were necessary bearing upon the question of security, but apart from their safety from that standpoint, the fact that by capitalizing the interest of these accounts they were absorbing more money than the bank was making year by year, would convince him that a very grave situation existed. I have illustrated the situation with reference to 1916 by a reference to the accounts above named, but other accounts were in a similar condition, and the combined effect of all these matters were danger signals of the most alarming nature.

For the reasons suggested above, I cannot satisfactorily work out an answer to this question from a comparison of assets and liabilities. I think it must have been as a result of looking at the matter in this light, on the part of the late Mr. Z. A. Lash, K.C., that as early as February, 1916, he wrote to Mr.

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Fisher, K.C., of Winnipeg (ex. 132, p. 292) the letter previously set out, in part, in my answer to question three, wherein he expressed doubt as to the possibility of the bank continuing in business, because, as he therein said:—

“Z. A. Lash to James Fisher.

“The amount locked up indefinitely in four large accounts, is probably three times the paid-up capital and more than half the total deposits.”

And he also alluded to the danger of even a slight run upon the bank.

Having regard to the condition of the bank in the years in question, from a comparison of the assets and liabilities, Mr. Edwards has testified as a result of his investigations that the assets of the bank in the year 1916 should have been reduced by the sum of three millions of dollars thereby leaving the liabilities and assets about even, thus assuring the depositors of the safety of their money, and that the entire capital and rest had disappeared (p. 515). In arriving at these figures Mr. Edwards put a valuation upon the assets, as it would be necessary for him to do, and while that is easily done at present, yet from the standpoint of the information available in 1916, I cannot say that it would have appeared so clearly to me at that time.

Mr. Clarkson, one of the liquidators, spoke very guardedly as to the exact position of the bank in 1916, but remarked (p. 283):—

“He must have felt that the bank was not earning profits sufficient to continue payment of dividends without capitalizing interest on accounts which were in jeopardy or at least in deep water; and that being the case, the situation must have appealed to him as a serious situation.”

And further says (p. 287):—

“There were a great many danger signs and the revenue situation was one of them.”

Down to May, 1916, the interest capitalized on the A. C. Frost & Co. account was estimated by Mr. Edwards at \$535,000 (p. 540), and it may not be out of place to say that until the date of failure interest had been capitalized to the extent of over two millions of dollars.

The financial condition of the bank in the year 1918 when the attention of the minister was drawn to it a second time, had become more serious, although returns to the government for that year gave no cause for apprehension. The returns showed (ex. 170, p. 495) paid-up capital to have slightly increased, it then being \$1,947,635. Reserve stood at the same figure, viz., \$300,000. The deposits showed almost five million dollars increase, being \$14,988,422. The total liabilities were \$25,842,635, and the assets \$28,270,766. From all of which it appeared, that if the assets were realizable, the bank was, from that standpoint, on safe footing. But an examination of the books would have shown—according to Mr. Edwards’ testimony—that the accumulated and unpaid interest for the years 1916, 1917 and 1918 amounted to \$676,000 (p. 509), which illustrates in a startling way how dangerous these frozen accounts were. Such examination would also have shown that in 1917 a profit of \$142,900 was shown in the bank’s statement, but that in that year interest to the extent of \$205,000 was capitalized and never collected (p. 271); that the earnings of the bank for 1918 were \$167,157 which was the most satisfactory showing for a long while, but as a matter of fact the annual statement represented the bank to have made \$228,963 in that year (p. 271).

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After the receipt of Mr. Machaffie's letter the minister reverted to his determination to refer the matter to the Canadian Bankers' Association, but for the reasons which have been duly detailed in answer to question 3, he was persuaded not to do so.

As to what further loss in capital had taken place between 1916 and 1918, it is difficult to form a conclusion. That some such impairment had taken place within that period is certain, although no details of amount are furnished in the evidence. Two yearly dividends amounting to over \$190,000 had in the meantime been paid.

The concluding part of this question asks:—

“What steps, if any, could have been taken by the Government to save the situation.”

In considering what the Government might have been able to do to that end in the years above mentioned, attention is directed to the probability of assistance from other financial institutions. By its continual supervision of banking matters and from the fact that there must be a renewal of the charter of each bank every ten years, it is obvious that the Department of Finance is in a position to exercise much influence with the Bankers' Association. While the Government has no power to compel one bank to take over another, and the Bankers' Association has no funds with which to assist a weak bank, nevertheless, the stability of banking institutions being supreme law in financial circles, one can see the force of the opinion expressed by Sir Thomas White, that intervention on his part would have resulted in the Home Bank being taken over by another bank or by other banks. Speaking strictly, such action could not be forced upon the Bankers' Association, or upon any bank, and therefore, if one is to consider what the Government could have done to save the Home Bank, apart from co-operation by the Bankers' Association or by other banks, the answer to such restricted enquiry is, I think, that the Government, after ascertaining the facts, could have closed the bank and forced liquidation at a time when, in my opinion, no loss would have fallen upon the depositors. But there still remained, however, the good services of other financial institutions responding to the express desire of the Department of Finance, especially when considering the imperative necessity for financial stability at that time. Whether, in view of the situation which would have been then disclosed by a proper audit and inspection, any other financial institution would have burdened itself with the Home Bank's liabilities or not, is a matter to which I cannot give absolute and definite answer. The evidence of Sir Thomas White is clear and distinct that he would not have allowed the Home Bank to fail at that time, but he would have had it taken over by some other institution, clearly explaining, however, that such action could not be made imperative upon any other bank. He was referring to the condition of affairs from a national standpoint, and to the overwhelming necessity at that time for keeping up a strong financial front in face of the world's demands, and replying upon the unquestioned patriotism of those who directed the issues of financial matters within Canada. Sir Henry Drayton expressed the same opinion. Keeping in mind these two spheres of operation open to the Government, it is clear I think, that all that it could have done to save the situation for the depositors would have been either to have closed the bank, forcing a liquidation of its assets to meet its liabilities as far as then possible, or have brought such influence to bear upon the Bankers' Association, or some other bank, as might have resulted in its amalgamation with another financial institution.

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Answer to question 5:—

I. The financial condition of the Home Bank was:—

In 1916:

(a) More than double its total paid up capital and reserve was locked up in four accounts, the securities for which were not realizable.

(b) No interest was being paid on three of these large accounts.

(c) No money was available for dividends except money belonging to the depositors, and the dividends paid from year to year were paid out of the depositors' money.

(d) A demand by the depositors for even a small percentage of their money could not have been met.

(e) The total paid up capital and reserve of the bank had been lost.

(f) A loss of assets calculated by Mr. George Edwards at over \$3,000,000, had been sustained, leaving the assets and liabilities about even.

In 1918

(a) There had been no reduction in the amounts due to the bank from their heaviest debtors, but on the contrary further capitalization of interest had taken place.

(b) All the weaknesses which existed in 1916 were accentuated.

(c) The dividends paid in the meantime, amounting to over \$190,000, had been paid out of money belonging to depositors.

(d) A further loss of assets had been sustained but the auditors were unable to state with any certainty as to the amount of such loss.

II. The only steps that the Government could have taken to save the situation would have been to make thorough investigation into the bank's affairs, which would have resulted:

(1) In forcing the liquidation of the bank, or,

(2) Bringing about its amalgamation with another bank.

It will be noticed that by Order in Council number 412, dated 17th March, 1924, the Committee of the Privy Council advised that the powers of the Commissioner under Order in Council number 306:—

“Be not limited to the specific years 1915, 1916 and 1918 referred to in the petition of the depositors, but should extend to an investigation of the affairs of the said bank during the whole interval between the issue of the bank's charter and the failure of the said bank, including any representations made to the Government of the day, as to its condition, any action taken by way of the Ministers of Finance upon such representations as may have been made, and the effect on the position of the depositors of any audit under section 56a of the Bank Act if made at any time in consequence of such representations.”

I beg to report that there is no evidence that representations of any kind were made to the Government concerning the Home Bank of Canada subsequent to the year 1918.

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After his retirement from office, correspondence took place between Sir Thomas White and his successor, Sir Henry Drayton, bearing upon the condition of the Home Bank, as set out in the evidence given before me by Sir Henry Drayton, but nothing requiring consideration here arises therefrom, as in any way bearing upon the substance of the depositors' petition.

An incidental reference to the Home Bank was made by Sir Henry Drayton to his successor in office, the Right Honourable W. S. Fielding, when the latter succeeded to the position of Finance Minister, but nothing was said as to the existence of the memoranda or letters above referred to.

No representations of any kind appear to have been made to either Sir Henry Drayton or to the Right Honourable W. S. Fielding concerning the condition of the Home Bank, and although the present Minister of Finance expressed himself as ready to give evidence before the commission, if required, it did not seem to me that anything had taken place which made such a step necessary. There was nothing to indicate that his attention had ever been drawn to the existence of the various memoranda or to the correspondence above dealt with.

Having reference therefore to the scope of the enquiry, as enlarged by Order in Council number 412, I beg to report that there were no representations of any kind made to the Government of the day as to the financial condition of the Home Bank of Canada after the year 1918, and consequently no action in that respect was taken by any of the Ministers of Finance.

All of which is respectfully submitted.

OTTAWA, the 10th day of June, 1924.

HARRISON A. McKEOWN,

Commissioner